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Colston, William Ainslie

Valuation--recapture--depreciation reserves

Washington, D.C.

[1922]

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Valuation—Recapture—Depreciation Reserves

BY

COL. W. A. COLSTON

Vice-President and General Counsel,
New York, Chicago & St. Louis Ry. Co.

An Address

Delivered at the 34th Annual Meeting of the Railway Accounting Officers Association, Cleveland, Ohio, June 8, 1922

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VALUATION—RECAPTURE—DEPRECIATION RESERVES

Col. W. A. Colston

PRESIDENT J. J. EKIN: I notice that just a little while ago there entered the room a gentleman who was formerly in accounting work and then gave added luster to the legal profession. During the recent war he rendered service in both the artillery and the infantry. He was the former Director of Finance of the Interstate Commerce Commission. I take great pleasure in presenting to you the Vice-President and General Counsel of the Nickel Plate, Colonel W. A. Colston. (Applause.)

COLONEL COLSTON: Fellow railroaders (applause), although our President did grab me up just as I came in the door and gave me first warning about thirty seconds ago, I can't make any excuse for unpreparedness, because when I was in this artillery service that he has spoken of, my lieutenant colonel used to say that the only regret that I had because of the transfer of our regiment from the infantry to the artillery was that I could no longer, as I could in the infantry service, get the boys up at six o'clock every evening at parade and make them listen to a speech for fifteen minutes. (Laughter.)

I am mighty glad to be back with you in railroad service. My experiences in Washington were fine. They were splendid. Let us grant that they were better than they could possibly have been in the hurly-burly of railroad existence, but take a catfish that is accustomed to swimming in just ordinary river water, and put him in the finest eau de cologne that exists, and he would rather get back to his mud hole. That is the way I feel about getting back with you boys again.

I think there are some pretty tough propositions ahead of us yet, and I agree with what the President said in his address, that the work of this Association is not all past by any means. One of the things that I think we ought to look into is the question of correlation of some of our accounts and settlements with Uncle Sam, so that what is done in one way will be balanced by what is done in another way.

We have heard a lot about the lack of coordination between the work of the Labor Board and the work of the Interstate Commerce Commission, the failure of harmonious adjustment between what the hand that gives the rate does and what the hand that pays out the rate does. You may have thought that as accounting officers you were not particularly affected by such questions, but I want to tell you there is another proposition which requires coordination, and in which as accountants you are very intimately concerned, and that is in the question of recapture of earnings.

Good times are coming on. Heretofore we haven't realized that

there is such a thing as excess earnings, but some of us are coming along pretty close to the line now, some of us have passed it, and we have got to see that in this respect we will do fairness to the Government and see that there is fairness done to the railroads. We must look to it that we play the game according to the rules of the game, and those rules should be announced before the game is started.

There is a great American pastime which varies in different parts of the country in the rules as to what hand is the better hand. All of these rules are fair enough if we know them at the beginning of the game, but if we have gotten our stack on the table, and have drawn to a flush, thinking that it is going to be the winning hand if we get it, and then after we have drawn our card and made our flush somebody announces that a straight beats a flush, we don't like it, after the game has started. (Laughter.)

Now, we have something like that right here.

Prior to 1907 or thereabouts—it has been a long time since I dealt with these matters—we could charge what we wished to, within reason, to operating expenses for improvements. There was no thought of depreciation. The idea was generally that we kept the old railroad going, and that it was a going concern, and you had to keep the whole machine so you could do business with it, and you charged off the cost of keeping up to standard without accounting for any depreciation.

After 1907 we began to have refinements in accounting, and we were required to charge depreciation on equipment, and we were permitted to charge it or not charge it on way and structures. So far as I know, there is only one large railroad in the country, and that is one with which I happen to be rather intimately acquainted, that did charge depreciation to any substantial degree on way and structures. You were permitted to charge or not charge in accordance with your judgment. Why? Accounting to be of any value must afford a true exhibit of the facts of the company's business. It is not a mere question of putting down columns of figures and making stereotyped statistical reports. The purpose of keeping accounts, as I understand it, is to show the condition of the company's business, and so that the people who are responsible for managing that business may know how to proceed. Nobody knew then, and nobody knows now, any generally applicable rule for depreciation of way and structures, and the Commission very sensibly left it to the judgment of the roads. In other words, the rule was that each road should determine for itself the facts and should account upon the facts so determined. Now, the railroads having been given that as the rule and having adopted that as the method and having said, as the roads of the country generally have said, "there is no depreciation of way and structures"; that, I submit, should be accepted as a fact. However much some of us may disagree with the majority or with individual roads in that respect, the convention has been established; and however willingly we may all admit that as to the individual item, the separate rail, the separate tie, the separate bridge, or the separate other structure, there is depreciation, yet the consensus of opinion of the railroad accountants and engineers of this country is that combining appreciation and depreciation, taking the whole road as a complete tool, or working machine, there is no net depreciation of way and structures. Consequently, you have charged nothing to operating expenses for such depreciation. You have lived up to the rule and when you have had your rate investigations, when you have paid your taxes, when you have had all the troubles that the railroad man has, you have not fallen back on the defense that you had to make good depreciation of way and structures, or that the Government or the people of the country had to pay for it.

We had a valuation act. We had no misgivings. Nobody knew what the valuation act would amount to. We went along swimmingly. Then came the transportation act, which says that there shall be a recapture of earnings and that the recapture of earnings under section 15a of the Interstate Commerce Act shall be based upon the value of property devoted to the transportation service, and that when the values required to be found under section 19a, or the valuation act, shall have been determined, those values shall be taken as the values upon which recapture shall be based.

Now, what is the situation? You have come along with, say, a hundred million dollar property. Omitting equipment, your way and structures cost and stand on your books at $100,000,000. You have not charged any depreciation on this account. You have not collected anything from the public for such depreciation. Your franchises have been computed and your taxes have been paid without any allowance for such depreciation. Your rates in the past have been fixed; your rates for the future under section 15a have been fixed; your reductions in charges as recommended by the Commission have been made; your reparations have been paid; all without any allowance for depreciation of way and structures, but when the time comes to value the property you receive an engineer's report which says, "The cost of reproducing this property is $100,000,000, just as its investment shows, but we find its condition is only 80 per cent of its cost new, and therefore we take 20 per cent off for depreciation, and you get $80,000,000 as your value." Now, if you are allowed before recapture only 6 per cent on that cost of reproduction less depreciation, you are allowed before recapture only $4,800,000, and if you actually earn $6,000,000, or 6 per cent, on your real investment of $100,000,000, you have to split $1,200,000 up with Uncle Sam and give him $600,000, although you have not collected anything from anybody for this used-up value of property devoted to the public service, and your accounting, with the approval of public authority, has been based upon a determination that such shrinkage of value, or depreciation, does not exist.

I think this little illustration will emphasize the necessity for our making an earnest effort to harmonize and coordinate the accounting practices under the accounting rules of the Commission, and the engineering practices under the valuation act. I think we may expect the full and fair cooperation of all of the bureaus of the Commission in such an effort at harmonious adjustment.

Now, I don't say whether it is better to charge depreciation or not to charge depreciation. I am not bringing that into the question. But, I say, let us get the rules of the game at the start and play it throughout one way or the other way, and don't let us work both ends against the middle. If we are to continue our old methods and are not to charge income for depreciation of way and structures, then obviously we must treat such depreciation as non-existent in determining valuations or capital accounts. If, on the other hand, we are now to admit depreciation in way and structures for valuations or capital accounts we must recognize that our income accounts have been overstated in the past and just as we raise reserves to cover overcharges and loss and damage, failure to acknowledge which has occasioned over-statement of income in the past, so should we now raise reserves by periodical charges to income until we have provided for that depreciation which was, but was not admitted, as well as for that depreciation which evermore shall be.

I thank you, gentlemen. (Applause.)

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